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Preferentialism in Trade Relations: Challenges for the World Trade Organization

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Abstract

This paper argues that preferential trade agreements (PTAs) and the World Trade Organization (WTO) are not substitutes, and while PTAs are without doubt here to stay, dispensing with a multilateral venue for doing business in trade matters is not a serious option. It is therefore necessary to seek out better accommodation between PTAs and the WTO than has been apparent to date. The law of the General Agreement on Tariffs and Trade (GATT)/WTO has systematically fallen short in imposing discipline on discriminatory reciprocal trade agreements, while procedural requirements, such as notifications, have been partially observed at best, and dispute settlement findings have tended to reinforce existing weaknesses in the disciplines. One approach to remedying this situation is to explore a different kind of cooperation—that of soft law. A soft law approach to improving coherence and compatibility between the WTO and PTAs may hold some promise, but the option also has its pitfalls.

JEL Classification: F1, F5, F6, K3

Contents

1. INTRODUCTION

Preferentialism in trade policy has exploded in the last 15 years and it is not going to disappear. Views differ as to whether and to what extent this creates problems for international trade governance, be it from an economic, political, or institutional perspective. Part of the vast literature on this subject has focused on the relationship between preferential trade agreements (PTAs) and the multilateral trading system. A key preoccupation is whether regionalism and multilateralism can coexist in a mutually supportive fashion, or whether burgeoning regionalism is in the process of undermining a global approach to trade relations. If the latter is the case—and many hold this to be so—an obvious supplementary question is whether it matters. The premise of this paper is that the World Trade Organization (WTO) uniquely provides political and economic "public goods", and this argues strongly for finding ways of ensuring complementarity between the two avenues for shaping international trade relations. This is a non-contentious starting point, since it would be hard to find a serious analysis arguing that the disappearance or functional castration of the multilateral trading system would enhance world welfare or constitute an improvement in global governance.

Yet the WTO has signally failed to regulate regionalism in a systematic manner, thus relegating this over-arching multilateral trade institution to what, in the face of runaway regionalism, Baldwin (2006) referred to as the role of an innocent bystander. If regionalism is here to stay and the WTO is being sidelined, an obvious question is what the WTO should do about it. This is the subject of the present paper. Three points may usefully be made at the outset. First, at the risk of stating the obvious, the WTO is not an exogenous entity of ill-defined provenance, but rather a construct of governments seeking to cooperate in trade matters. It is what the collective decisions of governments make it. Since this is true of PTAs as well, the central issue is how governments decide to balance their interests in different institutional venues. Secondly, among the more than 300 PTAs currently in force and the dozens still under negotiation, one encounters a huge variety of agreements in terms of policy coverage and design. Some embrace deep integration, going considerably beyond WTO rights and obligations, while others are partial, poorly conceived and of dubious economic or lasting political value.[1] These differences are not directly relevant to this paper, as it focuses upon rules and institutional arrangements in the WTO and not individual PTAs. Third, in considering how the relationship between PTAs and the WTO might evolve and be managed, no analysis is offered of the bigger question of what the future shape and role of the WTO might be in international governance arrangements. For present purposes, the sufficient argument is that multilateralism should be preserved and that therefore a better relationship needs to be defined between PTAs and the WTO.

The paper is organized into five more sections. The next section briefly reviews some similarities and differences between PTAs and the WTO. This discussion is intended to emphasize that: i) PTAs and the WTO are not substitutes; ii) dispensing with a multilateral venue for doing business in trade matters is not a serious option; and iii) it therefore becomes necessary to seek out a better accommodation between PTAs and the WTO than has been apparent to date. Section 3 examines the content and nature of General Agreement on Tariffs and Trade (GATT)/WTO attempts to regulate PTAs. It discusses the difficulties associated with the content and interpretation of the relevant

[1] Not enough is known about the detailed content of many of the existing PTAs, although a considerable amount of recent work seeks to remedy this deficiency. See, for example, Estevadeordal, Suominen, Harris, and Shearer (2009); Baldwin and Low (2009); and Roy et al. (2007).

GATT/WTO rules and some aspects of the intellectual debate about how far PTAs should be answerable to multilateral disciplines. This sets the scene for an analysis in Section 4 of alternative ways of addressing the PTA/WTO relationship. This section also introduces the notion of "soft law", which is discussed in Section 5. The paper argues that properly defined, an augmentation of soft law in the WTO's approach could contribute to a strengthened and more coherent set of international trade arrangements, as well as help to redefine the "hard law" aspects of the WTO's responsibilities. Section 6 concludes.

2. MULTILATERALISM AND REGIONALISM COMPARED

A paper of this nature cannot begin to do justice to the rich literature that compares multilateralism and regionalism on a variety of economic, political, and institutional dimensions. [2] Much of the economic analysis demonstrating that the welfare consequences of PTAs are ambiguous is based on the Vinerian concepts of trade creation and trade diversion. Some analyses seek to identify the most probable circumstances in which trade creation will trump trade diversion, while many empirical papers have estimated the relative impact of the two effects. The Kemp–Wan formulation is a static specification of the circumstances where preferential liberalization is unambiguously welfare-enhancing globally. It requires that preferential partners go to free trade and no trade diversion occurs (Kemp and Wann 1976). The main conclusion from this literature, however, is that no *ex ante* determination can be made of the welfare consequences of PTAs. What about a world in which the most-favored-nation (MFN) principle applies, in the style of the WTO? MFN trade would create conditions in which traders were able to do business with the most efficient partners at tariff-inclusive prices. But MFN trade is not free trade, and the theory of the second best tells us that discriminatory initiatives in an already distorted environment might yield superior welfare outcomes to the *status quo* when MFN liberalization is unattainable (Horn and Mavroidis 2001; Schwartz and Sykes 1998).

Ornelas (2008) constructs a model to show that when the interplay between economic and political motives in the Grossman–Helpman sense is taken into account (Grossman and Helpman 1994), free trade cannot be attained because of the political motivations of governments. The argument is that in an MFN world that does not deliver complete liberalization as a result of mixed government motives in setting policy, PTAs might be able to deliver a superior welfare outcome to an MFN regime. The main driving force behind this result depends on the notion of tariff complementarity, where tariffs against third parties fall when countries enter into preferential arrangements. A recent empirical paper by Estevadeordal, Freund and Ornelas (2008) backs up this theoretical finding, the practical implication of which seems to be that preferential trading partners have an interest in mitigating trade diversion. On the other hand, a study by Limao (2007) found that where regional deals have been done, MFN liberalization has lagged behind. A possible explanation for these contradictory results is that the reluctance to liberalize on an MFN basis following regional trade-opening arises because the liberalization has been exchanged for non-trade benefits. The Ornelas paper does not argue, however, that discriminatory liberalization cannot hurt third parties—merely that global welfare might improve to a greater extent in some circumstances than under MFN liberalization.

[2] Major contributions include Viner (1950); Meade (1955); Kemp and Wan (1976); de Melo and Panagariya (1993); Bhagwati and Krueger (1995); Grossman and Helpman (1995); Frankel (1997); Pomfret (1997); Fernandez and Portes (1998); Bhagwati, Greenaway, and Panagariya (1998); World Bank (2000); Srinavasan (2005); Baldwin (2006); Bhagwati (2008); and WTO (2011).

Much of the economic analysis is carried out in terms of tariffs. An important question is whether the same reasoning remains valid when non-tariff or regulatory policies are involved. It would seem that to the extent regulations can reasonably be characterized in terms of tariff equivalents, the same logic applies. In a world where deteriorated trade opportunities result from divergent and incompatible regulatory regimes, an estimation of the tariff equivalence of measures will not tell us what we need to know.

Combining economic and non-economic objectives in an analysis of the economic merits of preferential trade complicates the picture somewhat. The broad conclusion is that the case for an MFN-based regime cannot be made unequivocally on pure economic efficiency or welfare grounds. Nevertheless, a growing body of literature has in the last few years examined preferential trade arrangements in terms of the incidence of trade costs.

A good example of this is Baldwin's work on multilateralizing regionalism (Baldwin 2006). [3] In somewhat simplified terms, what Baldwin argues is that a "juggernaut" effect and a "domino" effect operate over time in the world economy. The juggernaut effect embodies the idea that liberalization begets liberalization through a repositioning of domestic interest groups as continuing liberalization shrinks the size and influence of the groups that oppose market opening. The domino effect arises as regional agreements stimulate further regional agreements because of the competitive implications of discriminatory preferences. When these forces are part of a world economy where production sharing and process fragmentation across frontiers are becoming more frequent, and nationally-based interests are becoming internationalized, constituencies against the prevalence of markets segmented by PTAs become stronger. This is largely a trade cost story, where rules of origin and other transaction costs associated with crossing trade policy jurisdictions become sufficiently irksome for producer interests to press governments to multilateralize the liberalization they have accumulated preferentially in PTAs. This process of rationalization is good for efficiency and over time will have the effect of resurrecting a multilateral vision of trade cooperation, which offers the attainment of greater economic efficiency than the alternative.

Some literature has focused specifically on motivations driving PTA formation that cannot easily be captured in formal welfare-analytic models (see Fernandez and Portes [1998], for example). The report of the first Warwick Commission (Warwick Commission 2007) enumerated several reasons why governments might become involved in PTAs. These include the enlargement of a trading entity to increase bargaining power with third parties, to counter slow multilateral processes, to go further and deeper in the exchange of policy commitments, to secure foreign policy (political) objectives, to lock in domestic reforms, to insure against future policy instability, and to avoid exclusion in a world of many PTAs.

Turning to non-economic reasons why a multilateral approach may be preferred, or at least why maintaining a multilateral system of trade governance is regarded as desirable, several factors have been identified. They are largely non-quantifiable and have to do with notions of inclusiveness, peace, and security. The WTO *World Trade Report 2007* (WTO 2007), for example, argues that experiences in the first and second half of the 20th century are a study in contrast between a world without a system of global governance and one that developed international institutions for cooperation. The first 50 years were punctuated by two world wars, a trade war, and generalized bouts of acute economic hardship. The post-World War II architects of international

[3] This work has been extended and some of the issues examined more closely in Baldwin and Thornton (2008) and Baldwin and Low (2009).

cooperation learned from these experiences and were determined to craft a system of international governance that entailed pre-commitment on policy behavior, imparted greater certainty and security in international relations, and fostered a sense of shared purpose in maintaining political and economic harmony. The post-war political and economic institutions are under strain today in a very different world from the one in which they were constructed, and this has engendered pressure for reform. But reform is one thing and institutional destruction is another. The idea that global institutions are necessary in an interdependent world supports a multilateral dimension to trade relations.

To sum up, it is apparent that economic welfare analysis does not offer unambiguous guidance for preferring non-discriminatory over discriminatory trade policy. But even if one were able to specify circumstances where multilateralism did better on these grounds, this would not eliminate motivations for PTAs that can define cooperation in ways beyond the reach of a non-discriminatory regime. By the same token, the multilateral trading system delivers benefits of both an economic and non-economic nature that are missing in a PTA framework. Insofar as these two approaches to trade cooperation are not perfect substitutes, the case is strong for finding ways of strengthening the ability of the WTO to influence and discipline PTAs, or at least to blunt their more exclusive and distorting features.

3. GATT/WTO LAW AND PRACTICE[4]

The GATT/WTO rules on PTAs are weak, and governments have not been able or willing to address the issue. Adjustments made to the rules on PTAs have been modest, in contrast to the modification and modernization of trade rules in many other areas over the years. Extant rules on PTAs are deficient in their coverage and specificity, and at a rather fundamental level they defy uncontested legal interpretation. Governments have almost never been able to agree through established procedural arrangements that any given PTA is in conformity with the multilateral rules. Moreover, existing multilateral jurisprudence is sparse, equivocal, and in a number of cases errs on the side of deference to preferentialism. This section will look more closely at the nature of these problems.

3.1 Core GATT/WTO Provisions

Four main provisions govern the exceptions from MFN permitted for PTAs.[5] First, Article XXIV of the GATT allows departures from MFN for customs unions and free trade areas. The key provisions here require that: i) customs unions or free trade areas must eliminate duties and other restrictive regulations of commerce on substantially all trade among the parties to the agreement; ii) duties and other regulations of commerce must be no higher or more restrictive against third parties following the establishment of a PTA; iii) any interim agreement must include a plan or schedule for the full establishment of a PTA within a reasonable length of time; and iv) prompt notification must be made of a decision to establish a PTA or of an interim agreement leading to a PTA, on the basis of which the GATT/WTO membership shall make recommendations to the parties to the agreement.

[4] This section draws heavily on the author's paper: "The TPP in a Multilateral World" in Lim, Elms, and Low (2012).

[5] See the WTO's *World Trade Report 2007* (WTO 2007: 305–320) for an exhaustive discussion of the issues surrounding preferential trade agreements from a GATT/WTO perspective.

Second, the Uruguay Round Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994, in recognizing the rapid growth in PTAs since the establishment of GATT in 1947, sought to clarify the criteria and procedures for the assessment of new or enlarged agreements and to improve transparency. Among the main adjustments or interpretations were: i) the establishment of a methodology for evaluating the general incidence of duties and other regulations of commerce against third parties after the establishment of a customs union; ii) the designation of 10 years, save in exceptional circumstances, as the reasonable length of time within which an interim agreement would become a full-fledged, compliant PTA; and iii) a strengthening of the notification procedures for PTAs. In February 1996, a Committee on Regional Trade Agreements was established with a mandate to assess the compliance of notified PTAs and consider the systemic implications of regionalism from a multilateral perspective.

Third, prior to the Uruguay Round attempt to tighten the multilateral rules and procedures on PTAs, the 1979 Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries (also known as the Enabling Clause) emerged from the Tokyo Round negotiations. In the name of special and differential treatment for developing countries, this decision relaxed the GATT provisions on PTAs for the latter group of contracting parties. The enabling clause authorizes developing countries to enter into regional or global preferential arrangements among themselves for the mutual reduction or elimination of tariffs, and in circumstances approved by the contracting parties, for the mutual reduction or elimination of non-tariff measures. Such preferential initiatives should be designed to facilitate or promote the trade of developing countries and not to raise barriers or create undue difficulties for the trade of any other contracting parties. Developing countries are obliged to notify any action taken under these provisions and be willing to consult upon request with any other party in relation to any difficulties. These provisions effectively removed practically all the already partial and under-developed mainstream disciplines of Article XXIV on South–South preferential arrangements.

Finally, Article V of the General Agreement on Trade in Services (GATS) sets out the rules for PTAs in the services field. The article is entitled “Economic Integration” and it allows preferential arrangements among members, provided they involve substantial sectoral coverage in terms of the number of sectors, volume of trade, and modes of supply. Agreements should not exclude *a priori* any mode of supply. In addition, substantially all discrimination should be absent or removed among parties in covered sectors in respect of existing and new measures, either upon the establishment of the agreement or within a reasonable time frame. These provisions are adapted from GATT Article XXIV. But they also track the enabling clause in relaxing the “substantially all” coverage criterion for developing country agreements, and in allowing discrimination against foreign juridical persons. The latter modifies a GATS Article V provision (paragraph 6) that allows juridical persons belonging to third parties to enjoy the benefits accorded to nationally-owned juridical persons of the parties to the agreement. GATS Article V makes no advance on GATT Article XXIV in terms of clarity or the level of discipline. Indeed, it is arguably even less stringent, not least because of some of the added complexities of services transactions compared to goods transactions.

3.2 The Parallel Universe of Preferential Trade Agreements

Four separate but related questions present themselves in light of existing GATT/WTO rules on PTAs. These questions are relevant to an analysis of the effectiveness or otherwise of the WTO's oversight of regional trade agreements. The first question is whether obvious lacunae exist in the GATT/WTO rules. The second concerns particular problems of interpretation or meaning that have attracted attention over the years. The third question is about GATT/WTO procedures dealing with the task of overseeing PTAs. The fourth question is about the role of dispute settlement in clarifying the GATT/WTO obligations in relation to PTAs.

To take the first of these, the most obvious gap in the framework of rules is the complete absence of any discipline relating to rules of origin for free trade agreements. The Uruguay Round Agreement on Rules of Origin is restricted to non-preferential origin rules only. This is a gaping hole in the GATT/WTO framework for PTAs, considering the fundamental role of rules of origin in determining market access and the conditions of competition within preferential areas (see, for example, Krueger [1993] and Krishna and Krueger [1995]). Origin rules can be highly restrictive by effectively extending the highest level of restriction on a good of any member of an FTA to the borders of all other members of the grouping. Moreover, problems of incompatible and restrictive rules associated with individual, overlapping agreements simply multiply with the number of agreements. A major reduction in the restrictive and distorting effects of multiple systems of origin rules would occur if "cumulation" of originating inputs into production were permitted from different sources.[6]

In the absence of multilateral rules in these areas it is no surprise that highly varied and incompatible systems of origin rules coexist among dozens of free trade areas. The GATT Article XXIV: 5(b) entreaty that "duties and other regulations of commerce maintained in each of the constituent territories and applicable … to the trade of contracting parties not … parties to such agreement shall not be higher of more restrictive than the corresponding duties and other regulations of commerce existing … prior to the formation of a free trade area …" is unenforceable in the absence of norms covering the design of rules of origin.

Any sufficiently restrictive origin rule can induce producers to switch to suppliers inside the preferential area in order to enjoy duty-free access to a partner market, and no tariff or regulation of commerce applying to a third party who has lost the market will have changed. Moreover, the limited ability of Article XXIV: 5(b) to impose discipline was driven home when the 1995 Uruguay Round Understanding on the Interpretation of Article XXIV introduced an explicit methodology for evaluating the general incidence of duties and other regulations of commerce against third parties after the establishment of a preferential agreement only with reference to Article XXIV: 5(a), which deals with customs unions. The understanding was silent in respect of free trade areas, which constitute the overwhelming majority of all PTAs in existence today (Fiorentino et al. 2007).

The provisions on PTAs are also silent on the treatment of a number of other GATT/WTO provisions. There is no indication, for example, of how tariff rate quotas in agriculture might be handled in PTAs. Similarly, exemptions from coverage with respect to the requirement to eliminate restrictive regulations of commerce list exceptions relating to the use of quantitative restrictions in certain circumstances (GATT Articles XI and XIII), restrictions on balance-of-payments grounds (Articles XII,

[6] See recent work by Gasiorek et al. (2009) and Estevadeordal et al. (2008) in Baldwin and Low (2008).

XIV, and XV) and public policy-related restrictions (Article XX). But this list does not include any reference to contingency measures such as safeguards, anti-dumping, and countervailing duties (Articles XIX and VI). We are left to speculate, therefore, as to whether parties to a PTA are given the choice of using such measures inside a PTA when they are applied to the trade of third parties. Practice varies among PTAs, but this can have a significant impact on the degree of trade discrimination arising from preferential agreements.

Second, a number of provisions have provoked discussion because of a lack of agreed definition. It has remained less than clear, for example, how the phrase "substantially all trade" is to be understood. The "substantially all" criterion cannot be seen as an economic welfare standard in isolation from the specific circumstances of a given situation. On the other hand, the drafters may have believed that the political economy of picking and choosing sectors for discriminatory treatment would be more likely to lead to trade diversion than trade creation. They may have also thought that the "substantially all" criterion would help to limit an unseemly and confusing proliferation of preferential regional agreements. Different ideas have been put forward over the years as to how this criterion might be defined. Even if an agreement were reached, however, the absence of provisions on preferential rules of origin would potentially undermine precision. As Estevadeordal, Suominen, Harris, and Shearer (2009) and Cadot et al. (2006) point out in the case of the North American Free Trade Agreement, for example, a well-appointed rule of origin can effectively deny Mexico's duty-free access to the markets of its partners.

Another provision on which clear definition is lacking is the length of time required before an interim agreement is brought into full compliance with the relevant GATT/WTO provisions. Similarly, we do not know how to define with any precision the requirement that tariffs and other regulations of commerce should be no more restrictive on the trade of third parties after the establishment of a PTA than they were before. As already noted, the absence of discipline on rules of origin further complicates an already difficult issue, especially in the case of free trade areas.

The third issue mentioned above concerns procedures for examining PTAs in the GATT/WTO. Prior to the Uruguay Round Decision on Interpreting Article XXIV, notified PTAs were generally taken up in the GATT Council and assigned to a working group for examination. The Committee on Regional Trade Arrangements (CRTA), established in 1996 after the completion of the Uruguay Round, was given the dual role of examining PTAs for compliance with GATT/WTO requirements and examining the systemic implications of such agreements for the multilateral trading system. Prior to the Doha Round, the CRTA made no progress with either aspect of its mandate, forcing the WTO membership to think again (Fiorentino et al. 2008). The Doha mandate on regional agreements covers both substantive provisions and procedures. As with earlier discussions on substance, little has been achieved.[7] On the procedural side, however, agreement was reached on a Draft Decision on a Transparency Mechanism for Regional Trade Agreements.[8] This shift toward additional emphasis on transparency, in contrast to further efforts to reform the rules, is a significant development that will be considered further below. A final, but very important point to make on the procedural front concerns the notification requirements contained in GATT Article XXIV, GATS Article V, and the Enabling Clause. These requirements are not always met, and even when they are it can be after an extended lapse of time. Little has been done at the multilateral level to improve compliance with these provisions.

[7] WTO. WT/MIN(01)/DEC/1: paragraph 29.

[8] WTO. WT/L/671, 14 December 2006.

The fourth issue mentioned above is the role of dispute settlement. Developments in this area illustrate the general lack of willingness on the part of the GATT/WTO membership over the years to use multilateral rules to constrain regional initiatives. Indeed, some writers have argued that the role of dispute settlement in relation to PTAs should be attenuated at best. Roessler (2000), for example, argues for limited judicial review for reasons of "institutional balance." Fabbricotti (2008) argues that customary law should be invoked to justify a "regional exception" to GATT/WTO law covering PTAs. In the Turkey–Textiles case the panel ruled that overall consistency of a PTA was not a matter for dispute settlement, but rather was a political question for the CRTA.[9] A similar position was taken in the EC–Citrus case. The US–Rules of Origin for Textiles and Apparel case argued for wide discretion in defining rules of origin under PTAs. The Argentina–Safeguard Measures on Imports of Footwear case decided there was no need to respect the non-discriminatory requirements of multilateral safeguard rules. All these cases simply illustrate that some combination of a lack of legal clarity and a temperamental disinclination to pursue tighter obligations through dispute settlement has supported the general tendency to indulge PTAs within the multilateral framework of trade rules.

3.3 From the Legal to the Procedural

Although the Doha Round mandate on regional trade agreements included consideration of substantive WTO provisions, progress has been halting. What has emerged, however, as the only result of the negotiations allowed to go forward on a provisional basis prior to the completion of the package as a whole, was the Decision on a Transparency Mechanism for Regional Trade Agreements adopted on 14 December 2006. [10] The Transparency Mechanism (TM) provides for the early announcement of PTAs not yet in force. A new PTA must be notified as early as possible, and no later than immediately after its ratification by the parties concerned. The WTO Secretariat is charged with providing a factual presentation of the details of new PTAs, prepared in consultation with the parties concerned but under the responsibility of the secretariat. This factual description cannot be used in dispute settlement or as a basis for further negotiations on rights and obligations, but it does serve as the basis for a consideration of the PTA in question by the CRTA. Any subsequent changes affecting the implementation or operation of a PTA must also be notified in a timely manner.

The fact that the TM has been allowed to go forward independently of the full results of the Doha Round would seem to suggest that WTO members are aware of the need for a better understanding of what is taking place in the name of regional integration. However, the TM is laced with caution, and is somewhat limited in terms of offering an opportunity for analysis or discussion of the contents and purpose of regional agreements. The fact that the secretariat's input serves as a basis for "consideration" and not "examination" is symptomatic of this caution. Governments are adamant that this exercise should only be about the provision of information, so the TM does not form part of the legal structure of the WTO. Perhaps this cautionary approach will be relaxed over time if members become less defensive and more willing to engage in a serious exercise of review with a view to reform.

[9] Turkey–Restrictions on Imports of Textiles and Clothing Products. WTO: WT/DS174/R.

[10] See http://www.wto.org/english/tratop_e/region_e/trans_mecha_e.htm

3.4 Summary Observations

Does the failure of the GATT/WTO to exert effective authority over PTAs on regionalism during the last 6 decades reflect the absence of an adequate framework within which to do so, or is it an unwillingness to craft such a framework that explains this long-standing legal and institutional vacuum? In reality, this is not a difficult question to answer. The flow of causality does not emanate from bad architecture, or from the limited capacity of legal drafters to fashion justiciable provisions—it is simply that most governments have not been prepared to challenge one another in terms of what they are doing on the preferential front in trade.

Even where legal challenges have been made, findings have tended to be permissive and yielding to regionalism. Moreover, it is noteworthy that some parties consider a failure by WTO members, or the GATT contracting parties before them, to rule that a free trade agreement or customs union is not in conformity with GATT/WTO may be taken to mean that the agreement in question conforms with the relevant provisions. This is indeed a comfortable position, since a decision that a PTA is non-conforming would require a consensus that includes the parties to the agreement under examination.

Baier and Bergstrand (2009) suggest we should not worry much about regionalism since the outcome of regional arrangements is generally positive for world trade. Most regional agreements turn out to be based on natural commercial alliances that have the effect of increasing trade. Authors such as Baldwin (2006) and Bhagwati (2008) are much less sanguine about the benign effects of PTAs, but this is something we shall return to in Section 4 in considering options for the WTO. The core point emerging from the above discussion, however, is where we began this section—from an institutional and a formal legal perspective, the GATT/WTO has left little discernible trace of influence on the shape or incidence of regional arrangements.

4. DIFFERENT APPROACHES TO COMPATIBILITY AND COHERENCE

Based on the premise stated at the beginning of this paper that the multilateral trading system provides unique benefits to international trade, the key question to which the rest of the paper is devoted is how multilateralism and regionalism might be rendered more compatible and coherent. This section identifies five approaches: i) obtaining agreement among governments to abandon regionalism; ii) filling the legal vacuum; iii) multilateralizing regionalism; iv) going to multilateral free trade; and v) adopting “soft law” approaches at the WTO.

The idea of abandoning regionalism has as much chance of succeeding as the medieval European King Canute did of willing back the tides. We have already discussed the fact that governments do not regard regionalism and multilateralism as perfect substitutes and it is therefore pointless to argue for the banishment of discrimination in international trade relations. The viable quest is for a better fit, for clarity and coherence—a global regime where alternative arrangements are complementary and mutually supportive. This will require willingness on the part of governments to think and act cooperatively in respect of their regional initiatives, combined with a fresh approach at the WTO.

The second option—to find legal fixes to contradictions and incoherence at the multilateral level—is also impractical, at least as a point of departure for a new

approach to compatibility. Embarking on this quest, as the GATT/WTO membership has done with little success more than once, seems to be built on the false premise that legal design rather than revealed policy preference is at the root of the problem. As discussed earlier, weak rules are the consequence of politics, not the cause of present failings in the relationship between regionalism and multilateralism. In any overall rendering of greater compatibility and coherence, the rules will need to be improved. But greater legal certainty and clarity can only be achieved in the context of a repositioned overall policy stance of governments toward the multilateral/regional relationship.

The third approach involving the multilateralization of regionalism, built on Baldwin's analytical construct (Baldwin 2006; Baldwin and 2008; Baldwin and Low 2008) is more about the dynamics of self-executing change based on shifting economic interests than it is about a program of policy action. As noted above, within this framework, political economy forces in a world of growing market openness, and international production-sharing pushes interest groups in the direction of demanding greater coherence among PTAs. This process leads over time to the fusion of multiple overlapping PTAs into larger entities, leading eventually to the logic of fuller multilateralization. Even though the process has its own locomotive, policy responses are vital to progress, leading to simplified rules of origin and the joining up of regulatory regimes.

A cautionary note should perhaps be sounded about the notion of multilateralizing preferentialism if it is not a process led by, and undertaken in, the WTO. In recent years a genre of preferential agreements usually referred to as "mega-regionals" has emerged. Three agreements currently under negotiation fit best within this category. These are, first, the Trans-Pacific Partnership (TPP) involving 12 countries—Canada, the US, Mexico, Peru, Chile, New Zealand, Australia, Malaysia, Brunei Darussalam, Singapore, Viet Nam, and Japan. The second is the Regional Comprehensive Economic Partnership, which includes the 10 ASEAN member states, plus Australia, the People's Republic of China, India, Japan, the Republic of Korea, and New Zealand. Finally there is the Transatlantic Trade and Investment Partnership, involving the European Union and the United States. The share of the world economy claimed by these countries is enormous, which is perhaps one reason they are referred to as mega-regionals.

The agreements have varying levels of ambition and focus. Generally, they seek to push the boundaries of economic cooperation beyond what exists today in the WTO and many other PTAs, thus reaping additional benefits through trade. RCEP is perhaps the least ambitious in terms of carrying forward a new trade agenda but appears to place emphasis on consolidating existing agreements among its members. It is noticeable that several of the countries involved belong to more than one of the groupings.

The suggestion has been made that agreements like this could be the cornerstone of a process aimed at multilateralizing regionalism. While this is possible, there is a risk that if and when these agreements come into force, they will tend to be more rivalrous than cooperative, which is possibly one reason we see some countries participating in more than one of them. There is also the reality that geopolitical tensions partly drive these integration efforts. This is why a process aimed at multilateralizing PTAs should be inclusive and WTO-driven.

The fourth approach to compatibility and coherence relies exclusively on policy action in the WTO. The idea is simple—the lower MFN-based limitations on trade become, the less significant are the discriminatory characteristics of regional arrangements. This, in effect, is a mirror image of the third approach, also leading to a multilateralized

outcome. The contribution of increased multilateral market openness is valuable, but it has become clearer over the years that many governments are willing to go further in removing the obstacles to integration at the regional level than at the multilateral level. So while market-opening initiatives may contribute to convergence and growing multilateralization, the process will rely heavily on actions that have taken place at the regional level and may be replicated on the basis of best practices at the multilateral level.

This is not the place to analyze in any depth why governments often feel more comfortable pushing a regional rather than a multilateral integration agenda. Abstracting from the idea that PTAs could be designed as exclusive and protectionist fortresses, several factors appear to be at play. In some cases, governments seem to feel that the pace and politics of integration are more easily managed at the regional level. A degree of experimentalism may also influence the choice. Moreover, many smaller countries in the trading system find it easier to identify and strike reciprocal bargains at the regional level. The combination of reciprocity and MFN does not favor small-country participation in multilateral negotiations. All this reinforces the notion that the WTO's core contribution is to supply the public good of enforceable rules, not to open markets. This is not to say the GATT/WTO has failed to contribute to market opening over the years, but rather that this contribution has been less vital than the system's rules-related functions. Besides, the WTO is the unique supplier of global trade rules, but trade-opening occurs in other venues, be they unilateral or regional. This is relevant when thinking about the central question posed in the present paper—namely, how the WTO can contribute to compatibility and coherence in the face of exploding regionalism.

The fifth and final approach identified here is for the WTO to adopt a more explicit "soft law" approach as a complement to the existing combination of "hard law" and dispute settlement. Soft law has not been formally defined, but it can be thought of as a set of extra-legal of non-legal norms of a non-binding nature (Footer 2008). In other parlance, soft law can be considered to fall somewhere on a spectrum that defines cooperation along a continuum from information exchange, to consultation, to comity. Comity is derived from a Latin word that means courteous, and is generally defined as a recognition, as far as is practicable, of each other's laws and legal systems. The next section takes up the idea that the WTO might play a role in developing soft law norms on regionalism that could later be harnessed to forge a clearer and more complete hard law set supported by WTO members.

5. SOFT LAW APPROACHES TO REGIONALISM AT THE WORLD TRADE ORGANIZATION

In a world where the hard law of the GATT/WTO has failed to impose discipline on discriminatory reciprocal trade agreements, where procedural requirements such as notifications have been partially observed at best, and where dispute settlement findings have tended to reinforce existing weakness in the disciplines, one approach to remedying this situation might be to explore a different kind of cooperation—that of soft law. Examples already exist of bodies of soft law. The WTO Agreement on Technical Barriers to Trade, for example, distinguishes between technical regulations that are mandatory and standards that are non-mandatory. For standards, a Code of Good Practice for the Preparation, Adoption and Application of Standards has been included as an Annex to the Agreement. The code is open for signature by governmental and

non-governmental bodies and WTO dispute settlement is unavailable as a remedy under the Code.

Closer to home from the present perspective, in 2004, the Asia Pacific Economic Cooperation (APEC) developed the APEC Best Practices for Free Trade Agreements (FTAs) and Regional Trading Agreements (RTAs). The 21 APEC members committed to twelve "high-standard" best practices. These include consistency with APEC trade and investment principles, GATT/WTO consistency, the adoption of WTO+ commitments, comprehensiveness in preferential trade agreements, transparency, trade facilitation provisions, consultation and dispute settlement provisions in agreements, simple rules of origin, commitments on economic and technical cooperation, a commitment to sustainable development, openness to accession by third parties, and provision for periodic review. Plummer (2007) develops another code of good practice, built around what he defines as sound practice in respect of trade in goods, trade in services, rules of origin, government procurement, competition, investment, intellectual property rights, monitoring and dispute settlement provisions, and technical barriers to trade. Some overlap exists between this listing and that of APEC. Plummer goes on to grade 11 preferential trade agreements involving APEC members from A to C. A good number of As and Bs appear in all policy areas with the exception of rules of origin, where Cs are the order of the day except in the cases of the ASEAN Free Trade Area (AFTA) and the Singapore–New Zealand agreement.

While the logic of focusing on the sorts of areas identified in the APEC and Plummer listings is difficult to challenge, the real question is how far these listings of good practices have shaped provisions or influenced behavior under the agreements. The mere existence of good practices may not be sufficient to influence outcomes significantly, unless: i) a regular assessment is undertaken and the parties involved accept to change their policies on the basis of such evaluations; or ii) the good practices are explicitly designed with a view to a later stage where hard law provisions will be brought to bear. The idea of using soft law in the GATT/WTO context discussed here is essentially to build the conditions for repairing inadequate hard law on regionalism. This is surely more difficult to do than simply agreeing to pursue best practices in the indefinite future, without any real verification process aimed at modifying behavior as needed.

A soft law approach offers the opportunity for governments, through a non-litigious form of cooperation and exchange, to forge a better understanding of their respective priorities and interests. Engagement of this nature could serve at least two purposes. First, a soft law approach could be designed to develop a code of behavior, or of good practice, once again with the intention of influencing behavior in a positive direction. Second, a soft law approach could be designed explicitly as a stepping stone toward the reformulation of hard law—the objective we assign it in this paper.

The first of these objectives might be thought of as akin to an economist's game theoretic specification of the problem. In an infinite time horizon repeated game scenario, a credible threat—built around a more or less specific understanding of mutual expectations—would be exercised in time $t+1$ in retaliation for damaging behavior in time t, thus ensuring cooperative behavior in the absence of a binding obligation. Footer (2008) argues that "soft responsibility" can arise through soft law, basically as an expression of "ordinary responsibility". That formulation would not require the presence of a credible retaliatory threat. Political scientists might characterize soft law approaches to cooperation either as rationalist or constructivist. A rationalist approach might look something like the economist's repeated game, where well understood interests allow a mutually accommodating implicit bargain to be struck, without any need for a formal contract. Presumably the implicit threat of retaliation

would be present. A constructivist focus would emphasize a positive additional outcome from cooperative interaction, where parties would actually modify their initial positions in the light of what they learned about other parties' perspectives on an issue.

All these ways of looking at soft law presuppose a sufficiently high degree of convergence in objectives and aspirations among the parties concerned for voluntary compliance to work. As Shaffer and Pollack (2010) point out, the prospects for success in this context depend on several key exogenous factors. These may include the relative power of partners, the distributional impact of cooperation, the degree of homogeneity in national (in this instance regional) regimes, and implementation costs.

If a soft law approach is not conceived as a way of conducting business into the indefinite future, but rather as setting the scene for the development of improved hard law, a number of other considerations come into play. Footer (2008) argues that soft law can strengthen hard law and serve as a precursor for building hard law. It is interesting to consider whether the prospects for such outcomes are affected if a pre-existing body of hard law is in place, so that the embrace of soft law is an attempt to repair something that needs fixing, as opposed to a green-field situation where soft law is just a step in a new process of rule-making. Since the context of regionalism in the GATT/WTO is about repairing something dysfunctional, the task will be considerably more challenging, as positions are likely to be entrenched around the issue of how existing rules should be modified.

Several problems arise with soft law. As Shaffer and Pollack (2008) argue, far from acting as complements over time, soft law and hard law could become antagonistic. If the underlying cooperative conditions are absent, because of such factors as distributive conflict and regime heterogeneity, the net result could be the hardening of soft law as a result of strategic bargaining around the soft law norms, and a softening of hard law because of diluted commitment and reduced legal certainty. At least two additional factors have to be taken into account in thinking about the role of soft law in rebuilding hard law, especially in the context we are considering in this paper. First, consensus around soft law norms will require a shared perception of the underlying objectives, and that seems to be precisely what is missing in the current state of affairs. Soft law cannot be anchor-free. It requires an institutional context linked to clear objectives. Second, a successful outcome requires that the parties to soft law arrangements share a view of how the transition to hard law will be made. The mechanics of this transition are unlikely to be easy.

Perhaps these considerations suggest the need for a three-stage approach in the case of regionalism in the WTO. The first stage would involve little more than is currently contemplated under the new Transparency Mechanism—that is, a stage prior to any commitment to build soft law norms. As things stand, governments would need to show greater boldness than is apparent so far in sharing and discussing information on PTAs, as well as permitting a more analytical approach to an examination of the issues. This could open the way for the evolution of soft law norms, or a code of good practice, building on the information generated in the first stage. Only after governments become comfortable with soft law, will negotiations be engaged to develop an improved hard law structure. This rather laborious process could be accelerated if conditions on the ground—continued proliferation of PTAs, rising trade costs, and limitations on perceived trading opportunities—favor a shared commitment to clean up the mess.

6. CONCLUSIONS

Regionalism is here to stay. The GATT/WTO has had limited success in regulating the explosion of regionalism and managing its costs and contradictions. The multilateral trading system and PTAs have potentially complementary characteristics and functions, and they are not perfect substitutes. These facts militate in favor of the quest to achieve greater coherence and compatibility between the WTO and PTAs. Moreover, such a quest comes at a propitious time, as the multiplication of overlapping and increasingly complex networks of PTAs is prompting new thinking about what should be done.

There is an important reason for preserving the WTO as a working institution that should be emphasized, despite its modest success in recent years in advancing its agenda. While PTAs are relied upon for different and often deeper cooperation among subsets of countries, this is achieved in the comforting knowledge that there is always the WTO. Partners in PTAs often resort to the WTO's dispute settlement mechanism instead of relying on their own provisions. But the dependency goes beyond dispute settlement. In driving forward their preferential agreements, governments rely on the fact here there is some sort of home base should problems arise. Despite its shortcomings, if the WTO were neglected into non-existence, trade policy would be much more fragmented and uncertain.

Moreover, the internal dynamics of regionalism in an increasingly joined up world with production sharing are raising trade costs and intensifying interest is approaches to the simplification of policy regimes. In short, just as the WTO approach to regionalism needs fixing, all is not well with regionalism either. This should create the basis for progress. This paper has discussed the sources of difficulty and focused in particular on an approach to the current stalemate that depends on soft law as a vehicle to promote the reform of hard law in the WTO, in a situation otherwise characterized by stalemate. Soft law embodies its own perils and the approach must be carefully fashioned.

The new Transparency Mechanism is a step prior to the design of soft law, which in turn might give way to a reform of hard law. This three-phase approach to eliminating the current impasse would seem to be necessary in the current circumstances, even if it will take time. The risk is that an explicit shift toward a reliance on process alone will be treated by some as an end and not a means to a strengthened multilateral framework. This will simply further weaken the WTO. The Transparency Mechanism brings us pure process for the first time in the GATT/WTO, considering that all other comparable exercises such as the CRTA were accompanied by a mandate to address substantive issues in parallel. This may be the case again in a completed Doha Round, but in the meantime the risk of further legal dilution should not be disregarded.

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